This column updates a 1985 column about whether a condominium flip tax, more precisely referred to as a transfer fee, is permissible. After 16 years, the answer now seems more affirmative than before although there is still no conclusive answer.

With the modernization of urban living, there has been a shift away from strict adherence to the common-law rule against unreasonable restraints on alienation. The rule against unreasonable restraints invalidates unduly restrictive controls on future transfers of real property. It prohibits an owner of a fee in property from creating conditions that function to bar a grantee from alienating property. This rule is rooted in English common law, where restraints on the alienability of land were viewed as an impairment on marketability and a bar to the full utilization of land for the benefit of society. Thus, the purpose of this rule was to favor the free transferability of real estate. Because a condominium is considered real property, the rule against restraints on alienation is applicable. However, there has been a growing trend away from strict common-law doctrine towards a more flexible approach to property rights.

Restraints on Alienation

Such a change is exemplified in the area of co-op housing. New York courts have long upheld the validity of restraints on alienation of co-op apartments. For example, it is permissible for a co-op to impose, pursuant to the provisions of its proprietary lease or offering plan, a flip tax or resale fee. Flip taxes are transfer fees paid by the seller or purchaser of a co-op apartment to the cooperative housing corporation as a condition to obtaining the needed approval by the co-op for the sale. While it is generally accepted that co-ops may institute such fees, the state Legislature and courts have not provided a definitive position regarding condominiums. This is because, unlike a condominium, a co-op is considered personal property, where restraints on transfers have long been permitted. Nevertheless, although distinguishable, co-op cases provide an important precedent for condominium cases because of the similarities between the two entities. In addition, in interpreting issues affecting condominiums, courts have often looked at similar issues affecting co-ops for guidance.

The Condominium Act, Article 9-B of the Real Property Law of the State of New York, is the governing statute. The Act expressly permits condominium bylaws to include provisions restricting aspects of private ownership. Although the Condominium Act does not contain any provisions that allow for a resale or transfer fee, it also does not specifically prohibit such a provision.

Recent rulings have permitted certain types of restraints on the alienation of real property in the context of condominium sales. For example, condominium boards have successfully integrated “first refusal rights” into their bylaws. In Anderson v. 50 East 72nd Street Condominium, the court upheld a right of first refusal granted to a condominium board. The court held that such a right did not constitute an unreasonable restraint on the alienation of the condominium unit. The right of first refusal, found in the condominium bylaws, provides that “in the event an owner of a unit wishes to sell that unit, the board has the first opportunity to purchase the unit or produce a purchaser for the unit at the same terms as offered by the proposed purchaser.” The board of managers must exercise this right within the specified time period (frequently 30 days).
days) after notification by the seller. In effect, this right allows the board to veto a resident-seller’s first choice of buyer. The right of first refusal is a preemptive right. Such a right does not give the board the power to compel an unwilling owner to sell. It merely requires the owner, when the owner decides to sell, to first offer the property to the board. The owner may protect the profitability of the sale by factoring the restriction into the selling price of the condominium. In addition, potential buyers must be alerted to the restriction.

Courts have started to recognize that condominiums, similar to cooperatives, necessitate a balance between individual rights and protections and the communal rights and protections inherent in such entities. In light of these rulings, it is foreseeable that a condominium transfer fee would be upheld if (a) authorized by the vote of a substantial percentage of the affected condominium unit owners and (b) the court finds that the fee meets the applicable reasonableness standard.

The Reasonableness Standard

Generally, New York courts will uphold restrictions on the alienation of property if such restrictions are deemed reasonable. The reasonableness test consists of three main factors: price, duration and purpose. A carefully drafted transfer fee (comparable to transfer fees generally adopted by co-ops) should meet all three prongs of this test.

Courts can evaluate the pricing of a condominium by looking at the fair market value of the property and factoring in the increased cost from the inclusion of the transfer or resale fee. The additional cost imposed by the resale fee is generally not substantial, consisting of a small percentage of the profits from the sale or a percentage of the original cost of the apartment. There is no substantial legal or statutory authority for assuming that a marginal increase in the cost to the buyer would unreasonably restrain the seller’s ability to alienate his property. Under a transfer fee provision, the owner-seller still receives the amount that he bargained for in the sale of the condominium, so his right of alienability is not affected; only his terms of negotiation are altered.

Courts in other jurisdictions applying a similar type of reasonable test have also upheld restrictions. For example, such restrictions were permitted when the costs incurred by the buyer or seller go towards benefiting the condominium as a whole, such as being used to offset maintenance costs for the common areas or to increase the working capital of the condominium association. With lower common charges, owner-sellers may actually receive a higher price from the sale of the individual unit. Thus, even if the increased cost is incurred is substantially, as long as the proceeds from the transfer fee are used to offset individual condominium owners’ common charges, a court in the State of New York should be persuaded to uphold the restriction. While this view is consistent with the common-law theory that the seller must be able to freely alienate his property, it also considers the realities of communal living.

The question of duration was the result of a concern that the restriction, which is typically included in the bylaws, does not run indefinitely, creating an unlimited restraint on the property and permanently hindering its alienability or transferability. New York courts should not automatically void restrictions on alienability which run indefinitely, but instead look at the appropriateness of the duration. Although a transfer fee’s duration is normally co-terminus with the condominium regime’s existence, if the restriction does not impair the value or use of the condominium, or restrict the holding period, then the provision should be considered reasonable under a duration evaluation. This is bolstered by the belief that the owner of the condominium may be encouraged to develop the property, to improve his likelihood to recapture such development cost from the sale of the individual unit. Courts have also recognized that condominium boards have a valid legal interest in enhancing unit values as well as managing ownership of the common areas and the individual units in the building.

The purpose prong of the reasonableness test functions as a balancing mechanism. Courts have the latitude to consider some of the social and public policy issues inherent in urban dwelling and condominium living. Courts have also looked at whether the reason for the restraint is rationally related to the protected common interest or the proper operation of the property. Additionally, the court should look at whether the purposes of the board are properly set forth in the bylaws or other governing instruments. Finally, courts should look at whether the power was exercised in a fair and nondiscriminatory manner.

Non-Governing Law

Courts in a number of jurisdictions outside New York have adopted more modern views, allowing reasonable restraints on the alienation of condominiums. Among these courts there has been a growing recognition that reasonable restraints on the alienation of condominiums are not inconsistent with the common-law presumption against conditions restraining alienation. These courts have recognized that, if the property is still marketable and has the same continued purpose, then the original interest in creating the property has not been abandoned; therefore, a number of pricing and leas-
ing conditions or limitations are legal.

For example, a number of jurisdictions, principally in Florida, have upheld broad leasing restrictions, including the authority of the condominium board to prohibit leasing of some of the residential units in the association.21 Such leasing restrictions have been found not to be unreasonable restraints on alienation. Additionally, courts have found that the condominium board has a legitimate right to adopt such a restriction to promote the residential character of the building.22 In comparison, such leasing restrictions appear to be more restrictive in scope than a transfer or resale fee, which does little more than increase the price to the buyer.

Although New York courts have been slower to follow this development, a few courts recently have begun to uphold leasing restrictions similar to those upheld in other jurisdictions. For example, blanket prohibitions by condominium boards, using power created by their bylaws, have been upheld as not constituting an unreasonable restraint on the alienation of an individual unit.23 This view is consistent with the well-established view that a condominium board has broad authority to enforce rules and regulations, as long as they are reasonable. New York courts have long given condominium and co-op boards significant judicial deference as long as the board acted for the purpose of the association or co-op, within the scope of the board’s authority and in good faith.24

In addition, courts have given greater deference to restrictions on alienation that are created by a unit owner vote and subsequently included as an amendment in the condominium’s bylaws.25 A higher level of deference is often given when courts review restrictive decisions made by bodies with fiduciary responsibilities, including condominium boards, which are then ratified by the persons affected. Such restrictions carry a very strong presumption of validity and will not be voided absent a showing that they are wholly arbitrary in their application, in violation of public policy or that they arrogate some fundamental constitutional right.26 If a transfer fee authorization is added as an amendment of the bylaws, with a two-thirds approval vote commonly found in New York co-op and condominium entities, it would arguably carry a similar presumption of validity because of the overwhelming approval of the unit owners. Thus, the fee will merit a higher degree of judicial deference than if the board had alone imposed the same.

Conclusion

Although there is no governing law that explicitly permits condominium entities in New York to institute a transfer fee provision, there is also neither a statutory bar nor case law prohibiting the same. In the past 16 years, in both New York and other jurisdictions, there has been a noticeable shift away from a strict enforcement of the common law rule against restraints on alienation. Courts have developed a series of standards, most using the reasonableness test, to determine if the proffered restriction is too much of a burden on the individual owner-seller’s ability to alienate property. If properly adopted, a transfer fee should meet all three prongs of a reasonableness test and be sustained upon judicial review.

(4) N.Y. Real Prop. Law §339-g (McKinney 2001).
(6) Siegler, supra note 1.
(7) N.Y. Bus. Corp. Law §501(c).
(10) See, Anderson 119 A.D.2d at 75.
(11) Id. at 74.
(12) See, Metropolitan Transportation Auth. 67 N.Y.2d at 150.
(13) Housing corporations have installed a wide spectrum of transfer resale fees. A flat fee, which may be graduated based on the size of the apartment is often elected. For a housing corporation, it is calculated as a flat fee per share of the corporation. The most commonly used methodology in New York City is based on a flat percentage of the selling price of the apartment. The percentage generally varies between 2-3 percent. Another variation involves a fee based on the percentage of the profit derived from the sale. See Siegler, “Cooperative Housing: Validity of Board-Imposed Resale Fees,” N.Y.L.J. at 1, col. 3 (June 13, 1984); See also, Siegler, “Limitations on Transfer Fees,” N.Y.L.J. at 1, col. 1 (Oct. 2, 1985).
(14) Since the 1980s both the courts and the New York Legislature have explicitly permitted co-ops to impose transfer fees, thereby increasing the cost of the individual unit in the building. Funds generated by such fees are often justified if used for maintenance, repairs and capital improvements to the property and common areas. Courts only void co-op transfer fees when the amounts are unequally imposed without the requisite approval of shareholders. See Siegler, “Flip Taxes Revisited,” N.Y.L.J., Sept. 2, 1987 at 1, col. 1. See also, Gurevich, “Business Corporation Law Change Accommodates Co-op Flip Taxes,” N.Y.L.J., Aug. 1, 1986 at 3, col. 1 (general background on the development of transfer fees).
(16) The question of duration falls in line with the concerns that brought about the Rule against Perpetuities. This rule voids any present or future estate if it suspends the absolute power of alienation beyond the lives in being at the creation of the estate, plus twenty-one years. It will also void any efforts at remote vesting. See Wint 79 A.D.2d at 424.
(17) See, Anderson 119 A.D.2d at 76.
(23) Four Brothers Homes at Heartland Condo. II v. Gerbino 262 A.D.2d 178; 691 N.Y.S.2d 114 (2nd Dept. 1999).

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